

[Assembly Bill 1021](#) (Steinorth)

Date: 05/07/15

Program: Sales and Use Tax

Sponsor: Author

Revenue and Taxation Code Section 6012.10

Effective: Upon enactment

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Summary: Specifies that the “gross receipts” and “sales price” from the retail sale of a smartphone are limited to the amount charged for the smartphone when it is sold in a bundled transaction, as defined.

Summary of Amendments: Since the previous analysis, the bill was amended to add coauthors and make technical, nonsubstantive changes.

Purpose: To minimize consumer confusion regarding the correct tax amount when they buy smart phones in a bundled transaction.

Fiscal Impact Summary: Annual state and local revenue loss of \$370 million.

Existing Law: The law¹ defines the terms “gross receipts” and “sales price” as the total amount of the sale, lease or rental price without any deduction for the cost of materials, labor or service, interest charged, losses, or any other expenses related to the property’s sale. Normally, the law regards a service sold in connection with a taxable good as part of the sale. Accordingly, the tax is based on the total receipts derived from that sale.

However, the marketing and retail pricing strategies associated with these devices and the telecommunications industry contradict conventional retail practices. As a result, in 1999, the Board of Equalization (BOE) adopted a [regulation](#)² to specifically address the application of tax on these device sales and related service charges.

Under the regulation, retailers are required to compute the tax based on whether they sold the device in a “bundled” transaction. The regulation defines “bundled” transactions as those sales where the customer is required to activate or contract for utility service with a wireless telecommunications service provider for a one-month period or greater as a condition of sale. Generally, to receive the device’s promotional or discounted sales price, customers must agree to activate or sign up with a provider for utility service for more than a one-month period. Under the regulation, the retailer is required to compute tax on the device’s sale based on the “unbundled sales price.”

The regulation further defines “unbundled sales price” as the price at which the retailer has sold specified devices to customers who are *not* required to activate or contract for utility service as a condition of sale. If the retailer has not previously sold a specific device in other than a bundled transaction, the unbundled sales price is equal to the devices’ fair retail selling price.

If the sale is unbundled (the customer is not required to activate or contract for utility service as a condition of sale), the tax applies to the device’s actual sale price.

Proposed Law: This bill adds RTC Section 6012.10 to the Sales and Use Tax Law to provide that the terms “gross receipts” and “sales price” from the retail sale of a smartphone shall be limited to the amount charged for the smartphone when it is sold in a bundled transaction, as defined.

The bill defines the following terms:

¹ RTC Sections 6011 and 6012, respectively.

² Regulation 1585, *Cellular Telephones, Pagers, and other Wireless Telecommunications Device*.

- “Smartphone” means a cellular radio telephone or other mobile voice communications handset device that includes all of the following:

- 1) Utilizes a mobile operating system.
- 2) Possesses the capability to utilize mobile software applications, access and browse the Internet, utilize text messaging and digital voice services, and send and receive email.
- 3) Has wireless network connectivity.
- 4) Capable of operating on a long-term evolution network or successor wireless data network communication standards.

A “smartphone” specifically does not include a radio cellular telephone commonly referred to as a “feature” or “messaging” telephone, a laptop, a tablet device, or a device that only has electronic reading capability.

- “Bundled transaction” means a retail sale of a smartphone that contractually requires the retailer’s customer to activate or contract for utility service with a wireless telecommunications service provider for a period greater than one month as a condition of that sale.
- “Wireless telecommunications service provider” means a utility regulated by the Public Utilities Commission or Federal Communication Commission and that offers or provides wireless communication or paging services.

As a tax levy, the bill becomes effective immediately upon enactment.

Legislative History: Four similar bills³ have been considered in prior years, but none were approved. The Assembly bills were held in the Assembly Revenue and Taxation Committee, and the Senate bill failed in the Senate Committee on Governance and Finance.

Commentary:

1. **The May 7, 2015 amendments** add coauthors and change the proposed new section number.
2. **The bill’s provisions would only apply to smartphones sold in a bundled transaction.** Sales of non-smartphones and devices such as laptops or tablet devices sold in a bundled transaction would continue to be taxed on the unbundled sale price.
3. **This bill’s enactment may lessen purchasers’ confusion.** Purchasers are generally accustomed to paying sales tax reimbursement to retailers based on the goods’ purchase price. However, the BOE receives numerous purchaser inquiries regarding the sales tax imposed on contracts involving purchases of smartphone devices, since the tax is computed so differently. This bill’s enactment would minimize these inquiries; however, limiting the exclusion to smartphones only may cause continued inquiries.
4. **Provisions apply prospectively.** Retailers have relied on the BOE’s applicable regulation to report their tax liabilities, and it appears that this legislation is not intended to apply retroactively.
5. **Bill should contain a delayed operative date.** The bill provides no lead time for the BOE to notify affected retailers and provide instructions related to their reporting obligations. Page 4 of this analysis contains a suggested amendment to provide the necessary lead time.
6. **The BOE Members unanimously voted to deny a petition to repeal Sales and Use Tax Regulation 1585.**⁴ In February 2015, the BOE received a petition requesting repeal of the regulation or portions of the regulation that clarify the measure of tax regarding wireless telecommunications

³ AB 2691 (Harkey, 2014), SB 1086 (Dutton and Garrick, 2012), AB 279 (Garrick, 2011), and AB 2320 (La Malfa, 2006)

⁴ *Cellular Telephones, Pagers, and Other Wireless Telecommunication Devices*

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE’s formal position.

devices sold in “bundled” transactions. The petitioner asserted that the regulation is inconsistent with the statutory definition of “gross receipts” in RTC Section 6012. BOE staff recommended that the Board Members deny the petition in its entirety because the regulation is consistent with the definition of “gross receipts” and judicial precedent interpreting that definition.

At the March 26, 2015 BOE meeting, the Members voted to deny the petition as recommended by BOE staff. Specific issues discussed by the BOE Members include:

- There have been several bills introduced to deal with establishing the taxable measure for sales of wireless telecommunications devices in bundled transactions. Because of the nuances in law and the unique practices involved, the Legislature is the best place to address this issue.

Administrative Costs: BOE will incur absorbable administrative costs to notify affected retailers, audit claimed exemptions, amend appropriate regulations, revise publications, and answer inquiries from taxpayers and the general public.

Revenue Impact:

Background, Methodology, and Assumptions According to statistics compiled by the *Consumer Electronics Association*, BOE staff estimates that the 2015 United States wireless smartphone handset market amounted to approximately \$51.3 billion. Based on a survey of the largest wireless providers, the average sales price of a separately sold handset is \$314, while the average price of a smartphone handset sold in a bundled transaction is \$90. Therefore, the average sales price for a handset in a bundled transaction amounted to 28.6% of the average sales price of a separately sold handset ($\$90/\$314 = 28.6\%$). For this estimate, staff assumes that the average sales price for wireless devices sold in bundled transactions is 28.6% of the sales price of these devices sold separately. Accordingly, the estimated annual revenue loss is calculated as follows:

Revenue Summary

U.S Smartphone Revenues 2015	\$ 51,300,000,000
California Sales: (12%)	6,156,000,000
Proposed Taxable Measure Providers (28.6%)	1,760,000,000
Adjustment to Taxable Measure	\$ 4,396,000,000
Estimated State and Local Revenue Loss (8.42%)	\$ 370,000,000

This revenue estimate does not account for any changes in economic activity that may or may not result from enactment of the proposed law.

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STATE BOARD OF EQUALIZATION
PROPOSED AMENDMENTS TO AB 1021

On page 3, line 16, after “effect.” insert the following:

However, the provisions of this act shall become operative on the first day of the first calendar quarter commencing more than 90 days after the effective date of this act.